Economic Trends

The Alberta economy is feeling the full impact of lower oil prices. Labour market conditions continued to deteriorate with employment declines intensifying in the second quarter. Consumers spending remained subdued as households faced falling earnings and economic uncertainty. The energy sector in Alberta continues to face hardship as historically low drilling activity and fire-related disruptions have hurt oil production. Though losses have been most intense in the oil and gas sector, weakness has spread to nearly every sector of the economy. This month's inFocus explores how the Alberta housing market has fared during the downturn.

Indicator	Latest Month	Value	Change year-over-year (y/y)
Employment (thousands)	June	2,250	-2.2%
Unemployment Rate	June	7.9%	+2.1 p.p.
CPI Inflation (unadjusted)	June	1.3%	-0.3 p.p.
Retail Sales	May	$6.2 B	-0.9%
Housing Starts (annualized)	June	24,001	-42.4%
Rigs Drilling (unadjusted)	July	58	-49.8%
Manufacturing Shipments	May	$5.0 B	-13.8%
Exports (unadjusted)	May	$5.6 B	-20.5%

Source: Statistics Canada, CAODC, CMHC. p.p.= percentage points.

Alberta Household Sector

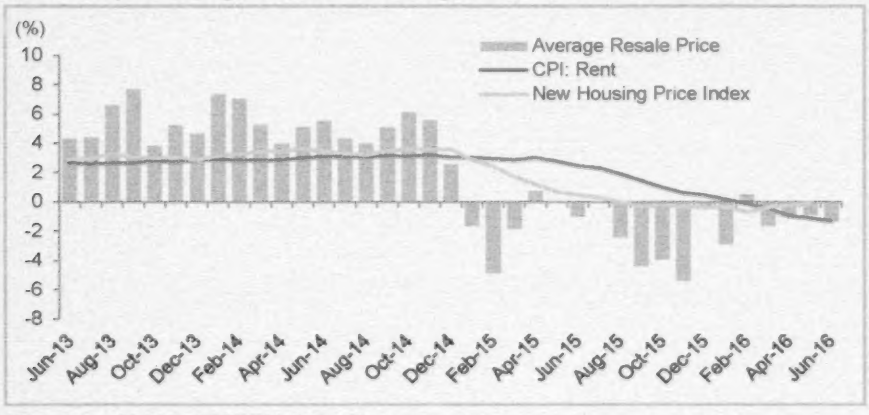
No easing of labour market strain

Halfway through 2016, Alberta's labour market is under considerable strain. The weakness intensified in the second quarter. June capped off the largest three month drop in employment on record, causing the unemployment rate to return to a twenty-year high. Employment Insurance claims have mounted, with the number of EI beneficiaries rising over 10% to a record 77,810 in May. Wildfire disruptions played a major role in the increase, with one third of the additional EI recipients residing in the Fort McMurray-Wood Buffalo region. The weakness has affected average weekly earnings, which in May were down 3.7% from a year ago, and 5.4% from the peak in January 2015.

Housing market remains weak

Alberta's housing market floundered in the first half of 2016, with both resale and new housing activity hovering near the lowest levels in several years. Despite some improvement in recent months, home resales-to-date remain down 11% from 2015. New listings have receded since spiking to a 7-year high in December 2015. This has resulted in a steady increase in the sales-to-new listings ratio as the market moves closer to balance. Housing starts have been trending around the lowest level in five years and through June were down 41% from the first half of 2015. Though the price correction has been modest, the average resale home price remains below 2015. This weakness has spread to the rental market (Chart 1) with rent in June down 1.3% from a year earlier.

Chart 1: Weakness in housing has spread to the rental market
Year-over-year change in Alberta housing indicators



Source: CMHC, CREA, Statistics Canada

Cautious consumers limit spending

Amid worsening labour market conditions, Alberta consumer spending remained subdued. Through May, retail sales were down 1.1% from the same period of 2015. Spending remained weak for a variety of consumer goods including groceries, clothing, electronics and appliances. Purchases of big-ticket items like cars and trucks were also down. Constrained consumer spending, low energy prices and a sluggish housing market have significantly muted inflationary pressures. CPI inflation was 1.3% in June and has been moderate for most of 2016.

Alberta Business Sector

Energy sector slumps

Alberta's energy sector continues to suffer from the prolonged impact of low oil prices. Alberta's oil drilling activity has consistently posted historic monthly lows in 2016, with the number of rigs drilling in the first half of the year down 50% from the same period last year. As a result of the decline in drilling activity, conventional oil production over the first five months of 2016 was down 16% from 2015 levels (Chart 2). Synthetic crude production was also down, because of maintenance shutdowns. Though crude bitumen production had been growing steadily, wildfire disruptions in May caused a sharp decline in output.

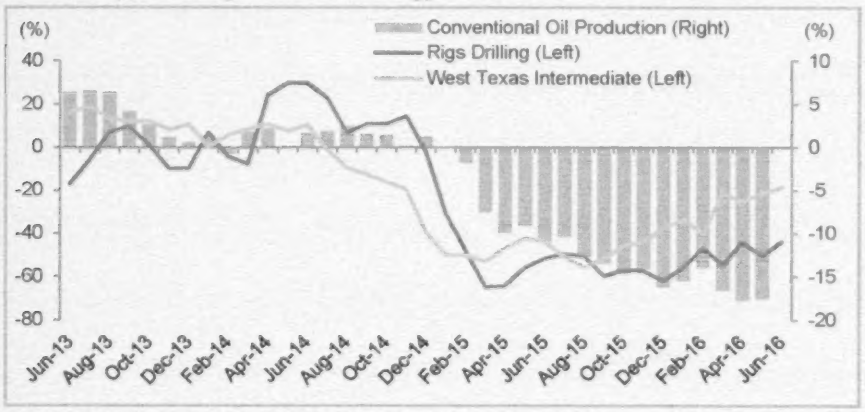
Across the board weakness in business activity

The contraction in the energy sector has driven the downturn in the Alberta economy, but weakness has spread to nearly every sector. The value of Alberta exports through May were down 25% from 2015. Although energy exports were the main drag, declines were seen in all but one export category (motor vehicles and parts). Similarly for manufacturing, sales were down 14% year-to-date, with wood product manufacturing the only category posting year-to-date gains. As with exports, most of the decline in manufacturing has been driven by falling energy prices, which have weighed on petroleum sales and curbed demand for Alberta's machinery manufacturing. This has caused food manufacturing to surpass petroleum and coal to become Alberta's largest manufacturing industry, despite slightly weaker food sales to date in 2016.

Investment trends lower

Weak economic conditions in the province continue to weigh on non-residential investment. Alberta non-residential building investment in the second quarter declined for the fifth-straight quarter and was down 7.5% from the peak in 2015. Declining investment in industrial and commercial building has more than offset a 52% year-over-year increase in institutional and government building investment. Much of the decline in industrial and commercial investment was concentrated outside of Edmonton and Calgary, while the increase in institutional and governmental investment was mainly in Alberta's two largest cities.

Chart 2: Conventional production has declined due to lower drilling
Year-over-year change in Alberta energy indicators



Source: Alberta Energy Regulator, CAODC, Haver Analytics

Global Economy

Global economy disappoints again

Global economic growth will remain lacklustre in 2016 according to the International Monetary Fund. The IMF lowered its global economic outlook by 0.1 percentage points for both 2016 and 2017. Although 2016 began better than expected, the result of the UK referendum to leave the European Union ("Brexit") has increased uncertainty and created significant downside risks to the global economy. The new forecast is contingent on Britain completing an orderly exit from the EU. In this base case the IMF expects the majority of the impact to be contained within the European region with only small impacts expected in other regions.

Bank of Canada lowers outlook

The Bank of Canada lowered its forecast for the Canadian economy in 2016 as exports and investment have failed to meet expectations. In addition, the forecast was adjusted to reflect the decline in oil production caused by the Fort McMurray wildfire. Growth in 2017 is expected to pick up to 2.2% supported by a lower Canadian dollar and an accelerating US economy. Like the IMF, the Bank of Canada does not expect Brexit to have much of an impact on the Canadian economy.

China's economy moderates

China continues to move to a more moderate rate of economic growth. Second quarter real GDP growth in China remained at a six-year low of 6.7% year-over-year. Policy makers are struggling to keep economic growth elevated as the economy transitions from an export to consumption-led economy. The People's Bank of China (PBoC) has cut its official lending rate six times over the last two years to encourage further credit and consumption growth. The PBoC has also allowed the Yuan to depreciate 6% against major trading partners since November.

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inFocus

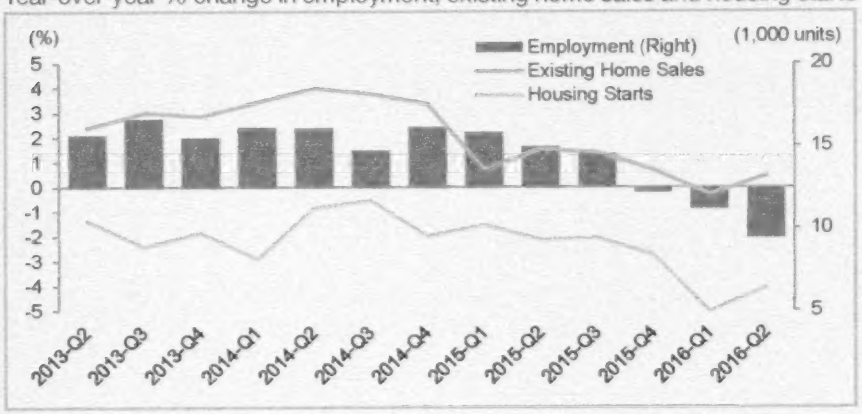
How housing is weathering the downturn

In the midst of the current recession, Alberta's housing market has softened. Alongside waning demand, sales of existing homes and housing starts have fallen, while rental vacancies have increased. This has put some downward pressure on home prices and rental rates. This inFocus explores the current state of Alberta's housing market.

Resale market activity remains low

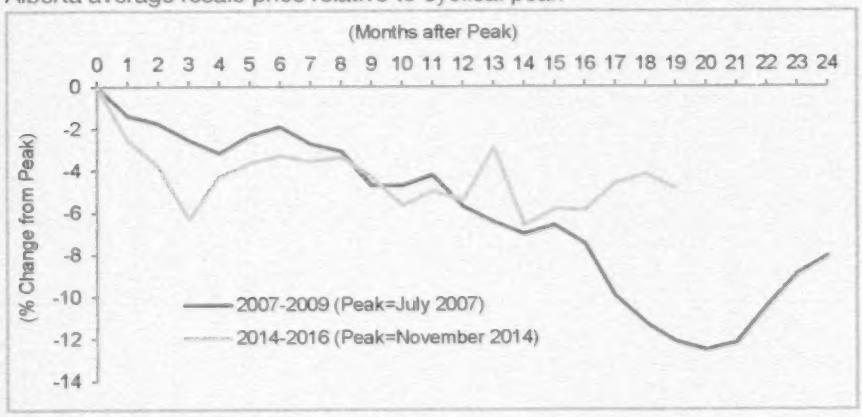
The resale housing market responded quickly to the drop in oil prices early in 2015, and persistently weak labour market conditions, slowing interprovincial migration, and increased uncertainty have kept activity subdued (Chart 1).

Chart 1: Resale market responded quickly to declining demand fundamentals
Year-over-year % change in employment, existing home sales and housing starts



Source: CREA, CMHC, Statistics Canada

Chart 2: Price correction has been moderate compared with 2007-2009
Alberta average resale price relative to cyclical peak



Source: Canadian Real Estate Association

The number of home resales dropped 31% between October 2014 to February 2015, as oil prices fell more than 40%. The number of new listings declined shortly thereafter. So far this year, home sales remain 30% lower than the 2014 peak and months of inventory has increased from 3.3 in October 2014 to 5.9 this June. This is above the historical average, but far less than the 9.8 months of inventory reached in December 2008.

Increasing slack in rental market

The rental market eased in 2015 after three years of tight conditions. After hovering around 2% for most of the last 3 years, Alberta wide vacancy rates jumped from 2.1% in October 2014 to 5.6% in October 2015. Over the same period, growth in rents slowed to 1.2% across the province. Rents appear to be coming down as the rental component of the Consumer Price Index has declined for 11 straight months.

Supply responds with a lag

Housing construction remained robust in the first half of 2015 before slowing substantially. Starts were supported in 2015 by record levels of multi-units, whereas single and semi-detached housing starts weakened throughout the year. So far in 2016, single and semi-detached housing starts have declined 32% and multi-unit starts are down 49%. Permits for all types of residential construction have declined 40% year-to-date.

Inventories are rising

Strong housing starts in 2015 and weakening demand have caused inventories of completed and unabsorbed homes to rise in the province. Inventories started to build in 2015, with the pace increasing in 2016. Inventories of multiple-units have

been steadily rising in both Calgary and Edmonton. The number of unabsorbed single and semi-detached homes in Calgary has barely changed; however those inventories in Edmonton reached an all-time high in May 2016.

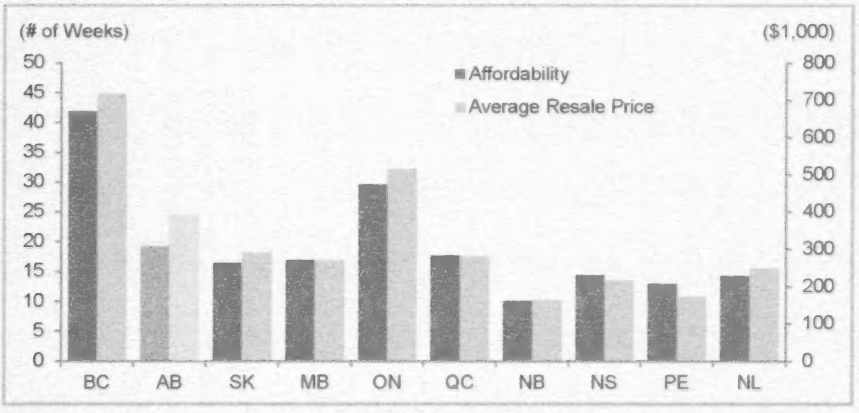
Home prices have held up

Despite weak demand and rising inventories, home prices have been resilient. The New Housing Price Index has remained relatively unchanged for the last 9 months to May and the Alberta average resale home price has declined 5% from the November 2014 peak to June 2016. By comparison, between July 2007 and March 2009, the average resale price fell by 12.5% (Chart 2). The price stability is partly a reflection of the balanced housing market leading into the current recession. Despite strong population and income growth over the last five years, the average resale price increased only 14%. This is in contrast to the five years leading up to the 2007 peak, when home prices more than doubled. Price levels in Alberta have remained relatively subdued compared to sharply rising prices in Toronto and Vancouver.

Chart 3: Low interest rates have helped to keep housing affordable
Affordability (see box for details) and average Alberta resale price

Source: Haver Analytics, Calculations by Treasury Board and Finance

Chart 4: Housing is much more affordable than in BC and Ontario
Average resale price and Affordability (see box for details)



Source: Haver Analytics, Calculations by Treasury Board and Finance

Housing remains affordable

The slower pace of home price gains, along with declining interest rates and rising income, have made Alberta homes more affordable over the last 9 years. One measure of affordability is how many weeks an average worker would have to work to pay a year's worth of mortgage payments (see box for details). In Alberta today, annual mortgage payments can be paid off in 19.2 weeks of earnings, one-third less than the 30.5 weeks needed in 2007 (Chart 3). Alberta affordability is significantly better than BC and Ontario. It takes 41.9 weeks of earnings in BC and 29.5 weeks in Ontario to meet annual mortgage payments (Chart 4).

Although affordability has improved, rising unemployment and falling incomes are weighing on household finances. The percentage of mortgages in arrears has also been rising since September, though it is still low by historical standards and compared to most other provinces.

Affordability Calculation

Affordability calculation is based on three monthly series; the conventional mortgage lending rate (5yr) from the CMHC, the average residential resale price from the CREA, and the average weekly earnings including OT (AWE) from Statistics Canada. It assumes a house is bought at the current average resale price with a mortgage rate equal to the current mortgage rate and amortized over 25 years with a 10% down payment. The sum of one year of mortgage payments is than divided by the most recent AWE. The results are expressed in the number of weeks required to pay one year's worth of mortgage payments.

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